

## Message Text

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ACTION EUR-12

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FM AMEMBASSY LONDON  
TO SECSTATE WASHDC 5213  
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SUBJECT: POLITICAL COMMENTS ON 1978-79 BUDGET

REF: LONDON 5657 AND 5934

SUMMARY: THE LABOR GOVERNMENT'S APRIL 11 BUDGET STATE-  
MENT DEMONSTRATES TO THE ELECTORATE THAT THE CUTS IN  
REAL INCOME SUFFERED 1975-77 HAVE BEGUN TO BE RESTORED.  
IT THUS HELPS PREPARE THE WAY FOR A GENERAL ELECTION  
WITHOUT POINTING TO A SPECIFIC DATE. IT LEAVES OPEN THE  
POSSIBILITY OF FURTHER MEASURES, DEPENDING PARTLY UPON  
THE OUTCOMES OF THE EC AND ECONOMIC SUMMITS IN JULY.  
MANY LABOR POLITICIANS WOULD HAVE PREFERRED GREATER  
INCREASES IN SOCIAL SPENDING BUT RECOGNIZE THAT THE TAX  
CUTS RESPOND TO POPULAR DEMAND. THE MOST PROMISING  
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INDEX, ELECTORALLY, IS THE DECLINING INFLATION RATE, AND  
THE GOVERNMENT IS ANXIOUS TO AVOID PRICE INCREASES. THE  
MODEST SIZE OF THE TAX CUT WILL HAVE LITTLE EFFECT ON  
UNEMPLOYMENT AND INDIVIDUAL DISPOSABLE INCOME. THE  
GOVERNMENT WILL ATTEMPT TO GET UNION SUPPORT FOR A PHASE  
IV WAGE GUIDELINE OF 5 PERCENT, ONE-HALF THE CURRENT RATE.  
THERE IS A GOOD CHANCE, THOUGH IT IS FAR FROM CERTAIN,

THAT THE FINANCE BILL WILL GET THROUGH PARLIAMENT WITHOUT AMENDMENTS THAT CHANGE ITS GENERAL THRUST AND WILL IMPROVE LABOR'S ELECTORAL PROSPECTS. IT MAY ALSO KEEP ALIVE HEALEY'S CHANCES OF SUCCEEDING CALLAGHAN AS LABOR PARTY LEADER. AN OPINION POLL INDICATED THAT TWO-THIRDS THOUGHT THE BUDGET WAS GOOD FOR THEM AND THE COUNTRY AND THAT THE LABOR PARTY HAD AGAIN CAUGHT UP WITH THE TORIES IN PUBLIC FAVOR. END SUMMARY.

1. THE FIFTH "ANNUAL" BUDGET ANNOUNCED BY CHANCELLOR OF THE EXCHEQUER DENIS HEALEY ON APRIL 11 CONSTITUTES A SIGNIFICANT CONTRIBUTION TO THE LABOR GOVERNMENT'S CAMPAIGN FOR REELECTION AT A GENERAL ELECTION WHICH MUST COME WITHIN THE NEXT EIGHTEEN MONTHS. ALTHOUGH THE REACTIONS OF THE LONDON STOCK MARKET AND FOREIGN EXCHANGE MARKETS HAVE BEEN ADVERSE, AND ALTHOUGH THE DIRECT TAX REDUCTIONS ANNOUNCED FELL FAR SHORT OF THE DEMANDS OF OTHER PARTIES AND ECONOMIC INTEREST GROUPS, THE BUDGET IS A "POPULAR" ONE IN THE SENSE THAT IT LEAVES VIRTUALLY ALL TAXPAYERS WITH A BIT MORE OF THEIR EARNINGS TO SPEND. THEREFORE, IT ADDS TO THE IMPRESSION THE GOVERNMENT WISHES TO CREATE: THAT THE SACRIFICES OF RECENT YEARS (REDUCED REAL INCOMES) HAVE BEEN WORTHWHILE AND THAT BETTER DAYS ARE AHEAD IF THE CONTINUITY OF POLICY IS NOT INTERRUPTED.

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2. THE MODEST EXTENT OF THE TAX REDUCTIONS AND STIMULUS TO THE ECONOMY REVEALS NOTHING OF THE GOVERNMENT'S INTENTION WITH REGARD TO THE POSSIBLE TIMING OF A GENERAL ELECTION. THE PRIME MINISTER AND CHANCELLOR HAVE REPEATEDLY FORESWORN ANY TEMPTATION TO "BUY" REELECTION THROUGH AN ECONOMICALLY AND FINANCIALLY UNJUSTIFIED "GIVEAWAY" BUDGET, WHICH WOULD LEAVE THE NEXT GOVERNMENT WITH HEIGHTENED PROBLEMS. THUS, THE APRIL 11 BUDGET IS A FURTHER DEMONSTRATION OF THE CALLAGHAN GOVERNMENT'S SENSE OF FISCAL RESPONSIBILITY AND WAS DESIGNED TO MAKE IT APPEAR MORE RESPONSIBLE THAN ITS LIBERAL PARTY INFORMAL PARTNERS, THE TUC AND CBI, AND THE CONSERVATIVE PARTY OPPOSITION MIGHT HAVE OFFERED. IT IS ALSO IN THE HEALEY "FINE TUNING" PATTERN -- HIS THIRTEENTH BUDGET STATEMENT IN FOUR YEARS. IN SUMMING UP THE PARLIAMENTARY DEBATE ON THE BUDGET APRIL 17, HEALEY SAID THAT ADDITIONAL STIMULUS MIGHT BE PROVIDED LATER IF THE ECONOMIC INDICES DEVELOP AS PREDICTED BY TREASURY AND IF THE RESULTS OF THE BREMEN EC SUMMIT AND BONN "WORLD" ECONOMIC SUMMIT MEETINGS IN JULY PROVE BETTER THAN CURRENTLY EXPECTED.

3. AS FORECAST, THE BUDGET RELIED MAINLY ON PERSONAL  
INCOME TAX RELIEF, RATHER THAN INCREASES IN PUBLIC

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EXPENDITURE, TO PROVIDE THE STIMULUS, EVEN THOUGH A  
LABOR GOVERNMENT'S TRADITIONAL INCLINATION WOULD BE  
TOWARD THE LATTER. A PROMINENT ECONOMIC MINISTER  
COMMENTED TO US PRIVATELY THAT AN INCREASE IN GOVERNMENT  
SPENDING WOULD MAKE BETTER ECONOMIC SENSE BECAUSE IT  
WOULD BE LESS SUBJECT TO THE BRITISH CONSUMER'S PRO-  
PENSITY TO IMPORT, AND THUS PLACE LESS STRAIN ON BALANCE  
OF TRADE AND CURRENT ACCOUNT. THE CABINET OPTED,  
INSTEAD, FOR TAX CUTS NOT ONLY TO STEAL THE OPPOSITION'S  
ECONOMIC CLOTHES, WHICH IT HAS DONE WITH SOME SUCCESS  
FOR THE PAST COUPLE OF YEARS, BUT ALSO BECAUSE THE  
GOVERNMENT'S GRASS-ROOTS CONTACTS CLEARLY ESTABLISHED  
THAT TAX REDUCTION WAS UNIVERSALLY PREFERRED -- EVEN  
AMONG THE UNEMPLOYED.

4. THE DIRECT BENEFITS OF LAST WEEK'S BUDGET ARE SPREAD  
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SO THINLY THAT THEY ARE UNLIKELY TO HAVE A SIGNIFICANT, LASTING, REAL EFFECT ON MOST OF THE ELECTORATE, EXCEPT AS ANOTHER STEP IN AN IMPROVING PROCESS. TAKING THE BUDGET IN A VACUUM, THE MOST OBVIOUS BENEFICIARY IS THE FAMILY AT THE VERY BOTTOM OF THE ANNUAL EARNINGS SCALE, THE PEOPLE WHO COULD BE CAUGHT IN THE SO-CALLED "POVERTY TRAP" WHERE WELFARE PAYMENTS MAY BE MORE ATTRACTIVE THAN A JOB. ABOUT 370,000 OF THESE FAMILIES WERE REMOVED FROM TAX ROLLS. TAKEN TOGETHER WITH AN INCREASE IN NATIONAL INSURANCE PREMIUM RATES WHICH BECAME EFFECTIVE EARLIER THIS MONTH AND A CHANGE IN THE METHOD OF CHILD BENEFITS FROM TAX DEDUCTION TO DIRECT PAYMENT, THE BUDGET LOSES MUCH OF ITS FAVORABLE IMPACT ON THE TYPICAL WAGE EARNER. THE ECONOMIST MAGAZINE CALCULATED THAT THE NATIONAL AVERAGE WAGE EARNER WITH TWO CHILDREN WILL ONLY BE SEVEN-AND-ONE-HALF PENCE (ROUGHLY FIFTEEN CENTS) BETTER OFF EACH WEEK AFTER ALL OF THESE ADJUSTMENTS. HIS WIFE, HOWEVER, WILL BE 2.10 POUNDS (\$4) AHEAD SINCE CHILD BENEFITS WILL NOW BE PAID DIRECTLY TO THE MOTHER.

5. ALTHOUGH HEALEY HAS INDICATED HIS INTENTION TO CHANGE THE BALANCE BETWEEN DIRECT AND INDIRECT TAXES, HE FAILED TO DO SO BY INCREASING VALUE ADDED OR OTHER INDIRECT TAX. (THE MINOR TAX INCREASE ON CIGARETTES OF HIGH TAR CONTENT IS MORE A HEALTH THAN A REVENUE MEASURE.) THE REASON IS CLEAR: WITH THE BALANCE OF TRADE AND CURRENT ACCOUNT ACTING BADLY IN TWO OF THE LAST THREE MONTHS AND THE PROSPECTS FOR GROWTH OF THE ECONOMY AND DECLINE IN UNEMPLOYMENT DEPENDENT IN PART ON THE DUBIOUS OUTCOME OF THE BREMEN AND BONN SUMMITS, THE BEST STATISTIC THE GOVERNMENT HAS GOING FOR IT IS THE FALLING INFLATION RATE. HIGHER INDIRECT TAXES WOULD RAISE THE COST OF LIVING AND MUST BE AVOIDED. THE MARCH

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RETAIL PRICE INDEX, ANNOUNCED THREE DAYS AFTER THE BUDGET, BRINGS THE ANNUAL INFLATION RATE DOWN TO 9.1 PERCENT,, AND IT IS WIDELY EXPECTED TO BE IN THE 7 PERCENT RANGE BY THE END OF THE SUMMER. A CABINET MEMBER TOLD US OF HIS NIGHTMARE THAT THE RATE WILL START UPWARD AGAIN IN THE MIDDLE OF A GENERAL ELECTION CAMPAIGN THIS AUTUMN.

6. THE BUDGET OFFERED NO DIRECT MEASURES TO REDUCE UNEMPLOYMENT, SUGGESTING THAT THE GOVERNMENT'S PRIORITY IS STILL ON REDUCING INFLATION WHILE PERMITTING MODEST

GAINS IN REAL INCOME. TUC CHAIRMAN BASNETT TOLD US THAT THE STIMULUS PROVIDED BY THE BUDGET WOULD CREATE PERHAPS 53,000 JOBS AT A TIME WHEN 1.4 MILLION BRITISH WORKERS ARE UNEMPLOYED.

7. HEALEY'S BUDGET MESSAGE ALSO MADE NO REFERENCE TO FUTURE WAGE POLICY, BUT THE SUPPORTING MATERIAL RELEASED LATER BY THE TREASURY CONTAINED THE ASSUMPTION THAT THE INCREASE IN LABOR COST WOULD BE HELD TO ONE-HALF THE CURRENT RATE -- IN OTHER WORDS, A 7 PERCENT INCREASE IN EARNINGS, IMPLYING A 5 PERCENT BASIC WAGE INCREASE. THE CABINET'S PAY POLICY COMMITTEE IS SCHEDULED TO MEET TUC REPRESENTATIVES THIS WEEK FOR A FIRST DISCUSSION OF THE POSSIBILITY OF GETTING MORE SUPPORT FOR A FOURTH YEAR OF WAGE RESTRAINT THAN THE TUC'S CURRENT POSTURE OF "ACQUIESCENCE PLUS A BIT." A MAJORITY OF UNION LEADERS ARE PROBABLY FOR A MORE SUPPORTIVE POLICY (ESPECIALLY TO MEET THE NEEDS OF A LABOR GOVERNMENT), BUT THE DECISION WILL DEPEND ON THE ATTITUDES OF THE COMMANDERS OF THE BIGGEST BATTALIONS, MOSS EVANS (JACK JONES' SUCCESSOR AT THE TRANSPORT WORKERS) AND HUGH SCANLON'S AS YET UN-CHOSEN REPLACEMENT AT THE ENGINEERING WORKERS. JONES, WHO REMAINS ON THE TUC GENERAL COUNCIL UNTIL THE SEPTEMBER CONFERENCE, AND EVANS HAVE THUS FAR BEEN NEGATIVE TO ANY FORMAL ARRANGEMENT, BUT EVANS RECENTLY

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COMMITTED HIS UNION TO "RESPONSIBLE" WAGE BARGAINING.

8. CAN THE MINORITY LABOR GOVERNMENT GET ITS FINANCE BILL ADOPTED BY THE HOUSE OF COMMONS WITHOUT CHANGES WHICH WOULD COMPROMISE ITS ECONOMIC AND POLITICAL OBJECTIVES? THE LIBERALS ARE EXPECTED TO INTRODUCE AMENDMENTS AT THE COMMITTEE STAGE FOR FURTHER CUTS IN PERSONAL INCOME TAXES, INCLUDING BOTH LOWERING THE STANDARD RATE AND REDUCING THE TOP RATES FOR HIGHEST EARNERS. THE CONSERVATIVES MAY INITIATE SIMILAR MOVES. IT IS IN THE LABOR PARTY'S INTEREST TO GIVE THE LIBERALS SOME OPPORTUNITY TO SCORE POINTS AMONG VOTERS WHO WOULD, OTHERWISE, MORE LIKELY VOTE FOR TORY CANDIDATES. THE GOVERNMENT IS PROBABLY PREPARED TO SWALLOW SOME LIBERAL-SPONSORED OR SUPPORTED AMENDMENTS, AS IT DID LAST YEAR WITH A CUT IN GASOLINE TAX. IF THE GOVERNMENT SHOULD BE LIMITED OFFICIAL USE

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CONFRONTED WITH TOO BASIC CHANGES IN THE FINANCE BILL OR IF CALLAGHAN SHOULD DECIDE THAT THE TIME HAD COME FOR A GENERAL ELECTION, AS ONE MINISTER REMARKED TO US LAST WEEK, LABOR WOULD BE ABLE TO CAMPAIGN AGAINST THE "IRRESPONSIBLE" EFFORTS BY OTHER PARTIES TO ADD TO INFLATIONARY PRESSURES FOR THE BENEFIT OF THE "PRIVILEGED FEW."

9. LASTLY, THIS BUDGET MAY BE SEEN AS ANOTHER SHOT IN HEALEY'S CAMPAIGN TO BECOME LEADER OF THE LABOR PARTY. MANY BELIEVE THAT CALLAGHAN WILL RETIRE IN A YEAR IF LABOR LOSES THE NEXT GENERAL ELECTION OR TWO YEARS IF HIS PARTY WINS. IF SO, IT WILL BE HEALEY'S BEST AND LAST CHANCE TO GAIN THE ULTIMATE PRIZE OF HIS POLITICAL CAREER. HE WOULD HAVE STRONG COMPETITION, AND THE OUTCOME WILL DEPEND UPON CIRCUMSTANCES AT THE TIME, ESPECIALLY UPON CALLAGHAN'S PERSONAL PREFERENCE IF HE IS HANDING OVER THE PRIME MINISTERSHIP, BUT A POPULAR, RESPONSIBLE AND -- ABOVE ALL -- SUCCESSFUL BUDGET WILL KEEP HEALEY IN THE RUNNING. A MORI POLL TAKEN AFTER THE

BUDGET STATEMENT (AND AFTER ANNOUNCEMENT OF DETAILS OF  
THE TORIES' MORE RESTRICTIVE IMMIGRATION POLICY)  
REVEALED THAT TWO-THIRDS OF THE SAMPLE THOUGHT THE  
BUDGET WAS GOOD FOR THEM AND FOR THE COUNTRY AND THAT  
LABOR HAD CAUGHT UP WITH THE TORIES AGAIN (CONSERVATIVES  
46, LABOR 44, LIBERALS 7 PERCENT) AFTER LAGGING BEHIND AS  
MUCH AS 11 PERCENT DURING THE PAST TWO MONTHS. BREWSTER

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